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In the

Supreme Court of the United States

October Term, 1965

No. 433

THE SHAMROCK OIL AND GAS CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals For the Fifth Circuit

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PETITIONER'S REPLY TO MEMORANDUM FOR RESPONDENT IN OPPOSITION

Respondent's Memorandum can be of little help to the Court. It evades the "depletion issue" and ignores completely the prime contention of Petitioner under the "bonus issue" to the effect that the Treasury Regulations relied upon by Respondent levy an unconstitutional tax on capital—not income.

DEPLETION ISSUE

"The representative market or field price (as of the date of sale) * * *" used in Treasury Regulations,[1] if here applicable, is not defined in the Regulations.

[1] Reg. 118 (1939 Code) Sec. 29.23(m)-1(e)(1); Reg. 111, Sec. 29.23(m)-1(f)

The Tax Court herein, in the first reported case involving natural gas, adopts a special definition, as applied to gas, which is contrary to and at variance with the definition of a like phrase in the Regulations applicable to minerals other than oil and gas.[3] See Petition, page 8.

Contrary to Respondent's assertion (Memo. p. 2), Petitioner does not approve the weighting of prices paid for volumes of delivered gas. The use of such method by the Tax Court, particularly, where, as was done here, there is included in such weighting, prices negotiated at earlier times under different economic conditions for the purchase of gas, of a kind not then usable for the higher valued uses for which it later became usable and valuable during the taxable period here involved, produces a fictitious price below that which like gas then commanded and was sold at the wellhead.

United States v. Cannelton Sewer Pipe Company, 364 U.S. 76, teaches that an integrated producer is to be put on a par with a nonintegrated producer by determining the price at which the nonintegrated producer sells his product before conversion and transportation. Under the rationale of *Cannelton* this is to be determined by substantial current sales of a comparable product in its raw state by nonintegrated producers, if there are such sales. The formula adopted by the Tax Court herein ignores such teaching in that it includes purchases that are neither current nor for comparable products.

The Shamrock Oil and Gas Corporation v. Coffee, 140 Fed. 2d 409 (CA 5) does not support Respondent. On the

[3] Reg. 118, Sec. 39.23(m)-1(e)(3).

contrary, it holds in line with this Court's later decision in *Cannelton* that the market price of sour gas is to be determined by buyers for the same product (i.e., sour gas and not sweet gas) in the same market (i.e., a current market).

It is true that *Hugoton Production Company v. United States*, 315 Fed. 2d 868 (Ct. Cl.) cited by Respondent follows the Tax Court opinion herein, but in such case there was not the lack of comparability in the compared gas as exists herein due to the technological developments that changed the uses for which Petitioner's sour gas could be put, thereby increasing the price it commanded at the wellhead during the taxable periods here involved. To the extent that the holding in *Hugoton Production Company* follows and supports the Tax Court herein, it is clearly wrong.

Petitioner submits that this Court's discretion should be exercised in favor of the granting of the Petition in order that the definition of the "representative market or field price" as applied to natural gas be reconciled with the teaching of *Cannelton Sewer Pipe* and with the definition of a like phrase in the Regulations applicable to minerals other than oil and gas.

BONUS ISSUE

The decisions cited by Respondent, i.e.: *Canadian River Gas Co. v. Higgins*, 151 Fed. 2d 954 (C.A. 2d), cert. den.

327 U.S. 793; *Sunray Oil Co. v. Commissioner*, 147 Fed. 2d 962 (C.A. 10th), cert. den. 325 U.S. 861; and *Murphy Oil Corp. v. United States*, 337 Fed. 2d 677 (C.A. 8th), cert. den. 380 U.S. 979, considered the treatment of a lease bonus to the lessee under applicable Treasury regulations and court decisions. Not one of these Courts, nor any other court of which Petitioner is aware, has considered whether the result required by such regulations and court decisions is within the bounds of the United States Constitution.

Respondent does not attempt to demonstrate the unsoundness of Petitioner's reliance on the Constitution but is content to base his opposition to this Petition solely on such decisions and regulations. Yet, if Petitioner's position is correct, those decisions and regulations cannot stand.

The 16th Amendment authorizes a tax on *income* only, without apportionment among the States and without regard to any census. The regulations and cases on which Respondent relies impose a tax on *capital*—not income. This Court's decision in *Eisner v. Macomber*, 252 U.S. 189, or any other sound analysis of the scope of the 16th Amendment, shows that such regulations and cases violate Article I, Section 2, Clause 3, and Article I, Section 9, Clause 4, of the Constitution of the United States, which prohibit a direct tax of the kind these regulations levy upon *capital*.

By his silence on this, the real question, it can be presumed that Respondent has no reply to the reason and logic of Petitioner's position.

This Court respectfully is urged to consider Petitioner's real contention against which Respondent in fact has offered no opposition by citation of cases and regulations.

The Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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